

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER 97-0480

Not-For-Profit Exempt Status
For The Period: Beginning June 1, 1992

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ISSUE

I. Gross Income Tax - Not-for-Profit Gross Income Tax Exemption

Authority: IC 6-2.1-3-20; IC 6-8.1-5-2; 45 IAC 15-3-2; 45 IAC 15-5-7

The taxpayer protests the Department's retroactive rescission of its not-for-profit status.

STATEMENT OF FACTS

The taxpayer was granted not-for-profit tax exempt status by the Indiana Department of Revenue in June of 1992. After an investigation spanning the approximate time period of July 1993 to November 1995, the Department revoked the taxpayer's Indiana Charity Gaming Annual Bingo License on an emergency basis and imposed fines totaling \$36,500 dollars as of January 11, 1996.

A hearing was held and a letter of finding was issued on February 5, 1996. In the letter of findings, the Department determined that the taxpayer was not a qualified organization, its volunteer workers were illegally paid, it used bingo proceeds illegally, it allowed a volunteer to participate in a bingo game, and it sold pull tabs that did not meet standards set by statute and regulation. Judicial review of the Department's findings and conclusions was conducted on February 26, 1996. The trial court issued its findings on March 12, 1996, finding the evidence sufficient to support all of the Department's findings. On November 20, 1996, the Court of Appeals of Indiana upheld the previous decisions and held that there was no error. On February 5, 1997, the Internal Revenue Service concluded that the taxpayer did not qualify for recognition of exemption under IRC § 501(c)(3) or § 501(c)(4). This denial was based upon the Department's 1995 investigation, the March 12, 1996 decision of the St. Joseph Superior Court, and the Indiana Court of Appeals decision on November 20, 1996. In a letter dated June 16, 1997, the Department rescinded the taxpayer's not-for-profit status effective June 1, 1992.

I. Gross Income Tax - Not-for Profit Gross Income Tax Exemption

DISCUSSION

The taxpayer protests the retroactive rescission of its not-for-profit status. The taxpayer argues that the June 16, 1997, letter rescinding its not-for-profit status is insufficient in its reasoning. The taxpayer contends that pursuant to 45 IAC 15-3-2(d) and 45 IAC 15-5-7 the Department failed to meet the three year statute of limitations on retroactive modifications and also failed to take into account the grounds for retroactive modification.

The taxpayer is a not-for-profit corporation incorporated on February 3, 1984, in the State of Indiana. The taxpayer's by-laws do not provide for loans or services to for-profit companies, nor do they provide for payment to members. All of the taxpayer's assets are pledged to charitable purposes and its real estate and personal property will revert to the benefit of the local government if the corporation is dissolved according to the by-laws. On June 8, 1992, the Department issued the taxpayer a Not-For-Profit Tax Registration Certificate, thereby exempting the taxpayer from gross income tax under IC 6-2.1-3.

45 IAC 15-3-2 pertains to rulings that are issued by the Department. 45 IAC 15-3-2(d) provides in pertinent part:

The department provides advice to taxpayers in many different forms. Rulings are issued to individual taxpayers based upon specific factual situations. Applications for rulings should be directed to the administrator of the particular division of tax from which the taxpayer is requesting a ruling. All relevant facts must be submitted in writing for such a determination to be made. The department will not issue a ruling based upon either an oral request or a written request from an anonymous taxpayer.

The taxpayer is incorrect in its interpretation of this section. The taxpayer's Form IT-35A, Application To File As A Not-For-Profit Organization, does not constitute a ruling. A taxpayer who fills out the IT-35A is applying for not-for-profit status from the Department and the application does not constitute a request for a ruling. As long as the form is completed in full by the taxpayer and is accompanied by the proper documentation such as, a copy of the federal determination letter (showing under which section the recognition of exemption was granted), a copy of the last Federal return filed, Articles of Incorporation, By-laws, etc., then the application is routinely accepted and not-for-profit status will be conferred upon the taxpayer. A taxpayer's actual not-for-profit status will only be challenged when an audit or investigation is initiated by the Department. Therefore, the provisions under 45 IAC 15-3-2(d),

concerning the grounds for retroactive revocation, are not applicable to the taxpayer's situation.

The taxpayer also argues that the retroactive revocation of its not-for-profit status is barred by the three year statute of limitations contained in 45 IAC 15-5-7. 45 IAC 15-5-7 provides in pertinent part:

Except as otherwise provided in IC 6-8.1-5-2, the statute of limitations for the assessment of a listed tax liability is three (3) years from the due date of the annual return (including extensions of time granted by the department) or the date on which the annual return is filed for the tax year, whichever is later...."

The Department's investigation into the taxpayer's charity gaming practices uncovered facts that called into question the taxpayer's not-for-profit status. Based upon those facts, the Department in its letter dated June 16, 1997, retroactively rescinded the taxpayer's not-for-profit status. This means, in effect, the taxpayer should have been paying gross, adjusted gross, or supplemental net income tax on the income it earned since June 1992. Because the taxpayer did not file the proper returns, or pay the tax for the years at issue, the three year statute of limitation under 45 IAC 15-5-7 does not apply. In fact, IC 6-8.1-5-2 states in pertinent part, "...if a person does not file a return, there is no time limit within which the department must issue its proposed assessment."

The question now becomes whether the taxpayer's not-for-profit status was properly withdrawn. In order to do so, the Department must determine whether the taxpayer meets the definition of a not-for-profit corporation. Pursuant to IC 6-2.1-3-20:

... gross income received by an... (6) not-for-profit corporation... that is organized and operated exclusively for religious, charitable, scientific, literary, educational, or civic purposes is exempt from gross income tax if no part of the gross income is used for the private benefit or gain of any member, trustee, shareholder, employee, or associate of the taxpayer. For purposes of this section, the term 'private benefit or gain' does not include reasonable compensation paid to an employee for work or services actually performed."

On February 5, 1997 the Internal Revenue Service, after having considered the taxpayer's application for recognition of exemption from federal income tax as an organization described in section 501(c)(3) and 501(c)(4) of the Internal Revenue Code denied the taxpayer's request for recognition as a not-for-profit corporation. The taxpayer is required to attach certain federal documents to its Indiana Form IT-35A. Most important of all is the federal determination letter. Form IT-35A states that this letter must be forwarded with the completed form. The Department's form IT-35A states at the bottom of the second page right above the signature:

IMPORTANT -- Attach the following documents that apply to your organization.

- (a) **Copy of federal determination letter** (ruling from the Internal Revenue Service) **showing under what section of the Internal Revenue Code recognition of exemption from federal tax has been granted.**
- (b) Copy of last Federal return filed, e.g., Form 990 PF, Form 990-T, Form 5500-C
- (c) If incorporated, a copy of the Articles of Incorporation and Bylaws
- (d) If not incorporated, a copy of Constitution and/or Bylaws, Articles of Association, Declaration of Trust, copies of amendments, and any changes presently proposed.

(Emphasis added).

Because of the administrative difficulties the taxpayer has had with the Indiana Department of Revenue and the resulting litigation the Internal Revenue Service did not grant the taxpayer not-for-profit status. This determination is evidence that cannot be overlooked.

It is apparent from the evidence presented at trial and in the administrative hearing, the taxpayer has a substantial non-exempt purpose of benefiting for-profit companies owned by person associated with the taxpayer. The evidence shows the taxpayer has made substantial payments to these for-profit companies. The payments served no exempt purpose. Most of the payments apparently were used to compensate bingo workers in violation of Indiana law. The taxpayer also provided these companies with space at no cost to them for rent, utilities, or maintenance. These activities for the private benefit of for-profit companies and the officers and executive members who own these companies are impermissible under IC 6-2.1-3-20.

The taxpayer also challenges the Department's findings based on Procedural and Substantive Due Process grounds. The Indiana Legislature conferred upon the Department the power to hold administrative hearings pursuant to IC 6-8.1-5-1 in order to resolve tax related issues. See also, Portland Summer Festival and Homecoming v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993). In this case, the Department is to apply the decision making process provided in IC 6-8.1 to determine whether the taxpayer should be granted not-for-profit status and then whether it should have been revoked retroactively. If after applying IC 6-8.1-5-1 to these issues as the legislature intended, the Department reasonably believes that the taxpayer does not qualify for not-for-profit status under IC 6-2.1-3-20, the Department shall make a finding as to why the taxpayer does not qualify on the basis of the best information available to the Department. The Department is then required to send the taxpayer a notice of the findings through the United States mail. The taxpayer then has sixty (60) to appeal the Department's findings.

The Department's letter of June 16, 1997 to the taxpayer states the following:

(The taxpayer) was granted not-for-profit tax exempt status by the Indiana Department of Revenue in June, 1992. This provided the organization with exemption from Indiana gross income tax and sales tax.

The Indiana not-for-profit tax exempt status of (taxpayer) is hereby rescinded, retroactively to June 1, 1992.

You have a right to appeal this decision. A written protest of this decision must be filed within sixty (60) days from the date this notification was mailed. Protest should be directed to:...

Upon receipt of your written protest, the matter will be set for review.

While proceedings before administrative bodies are not required to be conducted with all the procedural safeguards afforded by judicial proceedings, there are standards below which one cannot go. City of Mitchell v. Graves, 612 N.E.2d 149 (Ind. App. 1 Dist. 1993). In proceedings before administrative bodies, procedural safeguards should be at the highest level workable under the circumstances. Id. at 152. The state at a minimum must provide notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections. Yoder v. Elkhart County Auditor, 632 N.E.2d 369 (Ind.App. 5 Dist. 1994). Such notice must reasonably convey the required information to the affected party, must afford a reasonable time for that party to respond, and must be constitutionally adequate so the practicalities and peculiarities of the case are reasonably met. Id. at 372. The reasonableness of the notice given depends on the means chosen by the state to provide notice. Id. The Department's notice afforded the taxpayer sixty (60) days in which to protest the Department's decision. The taxpayer was also instrumental in deciding the date and time of the hearing.

The taxpayer finally contends that the letter dated July 16, 1997 was not adequate in detailing the reasons for the Department's retroactive revocation of its not-for-profit status. In reviewing the events surrounding the taxpayer's business practices it is clear that the state had sufficient reason to call into question the taxpayer's not-for-profit status. First, the Department conducted an investigation into the taxpayer's charitable gaming activities (January 11, 1996). The Department (February 5, 1996), St. Joseph Superior Court (March 12, 1996), Indiana Court of Appeals (November 20, 1996) and the Indiana Supreme Court (cert. denied) all held that the taxpayer was conducting charitable gaming activities illegally. The taxpayer's request to the Internal Revenue Service for not-for-profit status was denied (February 5, 1997), and the Department completed an audit as a result of the taxpayer having unrelated business income (July 18, 1996). All of these facts combined would lead anyone to question the taxpayer's Indiana not-for-profit status. The taxpayer was initially given sixty (60) days to protest the Department's Findings. Once the taxpayer protested, it had as much time as it needed to institute discovery, schedule depositions, or request Department files. With all these methods of discovery available to the taxpayer, there is no reason that a taxpayer should walk into a hearing unprepared. Therefore, the Department's notice was timely and proper, and any alleged inadequacy of the notice could have been cured by the taxpayer through proper discovery. Also, because the taxpayer has a right to protest the notice, the Department's determination is not final until this Letter of Findings is issued.

FINDING

The taxpayer's protest is denied.